

## US: Taxpayers need to consider international tax implications of making certain net operating loss elections under Revenue Procedure 2020-24

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In [Revenue Procedure 2020-24](#) (issued 9 April 2020), the United States (US) Treasury Department (Treasury) and the Internal Revenue Service (IRS) establish the timing and methods for making certain elections related to the carryback of net operating losses (NOLs) under Internal Revenue Code Section<sup>1</sup> 172, which were enacted under *The Coronavirus Aid, Relief, and Economic Security Act*, P.L. 116-136 (CARES Act).

### Background

In 2017, P.L. 115-97 (commonly referred to as *The Tax Cuts and Jobs Act* or TCJA) repealed taxpayers' ability to carry back NOLs to prior tax years. The TCJA also limited deductions for NOLs incurred in tax years beginning after 31 December 2017, to 80% of the taxable income in the carryforward year.

The CARES Act allows the carryback of NOLs incurred in tax years beginning after 31 December 2017, and before 1 January 2021, to each of the five tax years preceding the loss year and suspends the 80% taxable income limitation for NOLs incurred in tax years beginning before 1 January 2021. For NOL carrybacks, taxpayers may elect under Section 172 to skip any tax years during the carryback period in which they had an amount includible by reason of Section 965(a) (a Section 965 inclusion year); if the taxpayer does not elect to skip its Section 965 inclusion years, the CARES Act treats the taxpayer as having made an Section 965(n) election for those tax years.

## Revenue Procedure 2020-24: Deemed Section 965(n) election and definition of a Section 965 inclusion year

In determining an NOL deduction or the amount of a NOL carryover or carryback to a Section 965 inclusion year, taxpayers were allowed to elect under Section 965(n) to disregard a Section 965(a) inclusion of any associated foreign taxes that are deemed paid under Section 960 and treated as a dividend under Section 78. Treas. Reg. 1.965-7(f)(2) provides further that the Section 965(n) election also applies to determine a taxpayer's NOL in the Section 965 inclusion year. As a result, if a Section 965(n) election is made, an NOL deduction allowed in the Section 965 inclusion year cannot reduce the taxpayer's Section 965(a) inclusion (and any associated Section 78 dividend). The election can also result in the taxpayer having a current-year NOL in the Section 965 inclusion year.

Revenue Procedure 2020-24 addresses three Section 965 issues that are relevant to the carryback of NOLs. First, it provides that the election to skip a year in the carryback period applies only to a tax year in which the taxpayer had an actual inclusion by reason of Section 965(a). As a result, a taxpayer that did not have an actual Section 965(a) inclusion (because its pro rata share of E&P deficits exceeded its pro rata share of the positive E&P of its deferred foreign-income corporations) may not elect to skip tax years in its carryback period.

Second, Revenue Procedure 2020-24 states that a deemed 965(n) election applies only for purposes of carrying back an NOL to a Section 965 inclusion year. Thus, it is the position of Treasury and the IRS that, if a taxpayer did not make an actual Section 965(n) election (or revoke a Section 965(n) election), the deemed Section 965(n) election does not prevent other current NOLs or NOLs carried forward to the Section 965 inclusion year from reducing the taxpayer's Section 965 liability. Under this position, the deemed Section 965(n) election will not release a current-year NOL or NOL carryforward that the taxpayer otherwise used to reduce its Section 965 inclusion.

Finally, Revenue Procedure 2020-24 states that an election to skip a Section 965 inclusion year applies to all Section 965 inclusion years excluded from the carryback period and is not revocable.

Revenue Procedure 2020-24 establishes the timing and manner for electing to skip Section 965 inclusion years. For NOLs arising in a tax year beginning in 2018 or 2019, the election must be made by the due date, with extensions, of

the tax return for the first tax year ending after 27 March 2020. The election for NOLs arising in a tax year beginning after 31 December 2019, and before 1 January 2021, must be made by the due date, with extensions, of the tax return for the tax year in which the NOL arises.

The election to skip Section 965 inclusion years is made by attaching a statement to the earliest filed, after 9 April 2020, of: (1) the tax return for tax year in which the NOL arises, (2) the claim for a tentative carryback adjustment on Form 1045 or Form 1139 to a tax year in the carryback period, or (3) the amended tax return applying the NOL to the earliest carryback year that is not a transition year.

### Implications

For NOLs in tax years beginning in 2018 or 2019, many taxpayers will want to quickly file either a claim for a tentative carryback adjustment or an amended tax return applying the NOL to the earliest carryback year once the IRS recommences accepting paper-filings. Before seeking a refund, taxpayers will need to understand the collateral impacts of the carryback. Similarly, due to the requirement to elect to skip Section 965 inclusion years on the earliest of these refund claims, these taxpayers will need to determine the collateral consequences of the transition-year-exclusion election. Taxpayers with NOLs arising first in tax years beginning in 2020 will have more time to assess these collateral consequences.

International tax considerations in carrying back an NOL and electing to skip Section 965 inclusion years include the following:

### Section 965 transition tax liability and Section 904 FTC limitation

- ▶ Carrying an NOL to a pre-Section 965 inclusion year may increase foreign tax credit (FTC) carryforwards available to offset a taxpayer's income tax liability (including Section 965 transition tax liability) in a Section 965 inclusion year.
  - A greater NOL deduction will reduce a taxpayer's Section 904 FTC limitation, which will generally result in FTC carryforwards that may offset a regular tax liability in other years.
  - Domestic-source NOLs may create or increase overall domestic loss (ODL) accounts (a beneficial tax attribute).
  - Foreign-source NOLs may create or increase separate limitation loss (SLL) or overall foreign loss (OFL) accounts (detrimental tax attributes) and limit the ability to use FTCs (including in a Section 965 inclusion year).

- ▶ If a taxpayer elected under Section 965(h) to pay its Section 965 transition tax liability in installments, any reduction to a taxpayer's Section 965 transition tax liability by reason of an NOL carryback would not result in an immediate refund. Instead, future Section 965 transition tax installment payments would be reduced.
- ▶ Claiming a refund due to an NOL carryback frequently requires amending a return, requiring reexamination of positions impacted by subsequently finalized regulations.

### Section 59A (BEAT) liabilities

- ▶ Carrying back an NOL to a tax year in which Section 59A is effective may create or increase a taxpayer's BEAT liability. Under current law, a taxpayer's BEAT liability generally equals the excess of 10% of its modified taxable income over its regular tax liability less certain credits. Thus, any reduction to a taxpayer's regular tax liability by reason of an NOL carryback may be offset by an equal increase to its BEAT liability.
- ▶ Consideration should be given to waiving deductions (including on an amended return) to limit adverse BEAT impacts.

### Section 250(a)(2) taxable income limitation

- ▶ Section 250(a)(2) reduces a domestic corporation's allowable Section 250(a)(1) deduction when the sum of its foreign-derived intangible income (FDII) and global intangible low-taxed income (GILTI) exceeds its taxable income for the year (determined without regard to Section 250). Carrying back an NOL, therefore, may reduce a taxpayer's allowable Section 250 deduction; thus, the taxpayer would be forced to use an attribute that might otherwise offset income taxable at a 21% rate to offset income (GILTI and FDII) that is effectively subject to lower rates because of the Section 250 deduction.

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## Endnote

1. All "Section" references are to the Internal Revenue Code of 1986, and the regulations promulgated thereunder.



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